ACCOUNTING POLICY

TOPIC: Section 8--Capital Assets 1.2	EFFECTIVE DATE: 10/19/84
TITLE: Guidelines for Capital Asset Valuation	REVISION DATE: 9/24/04
AUTHORIZED BY: Cheryl Thompson, Financial Manager	PAGE 1 OF 4

BACKGROUND

This bulletin details guidelines for capital asset valuation, except that state capital projects for fund 490/495 are capitalized as described in Section 8—Capital Assets 2.1 (Capitalization of Fund 490/495 Construction Projects).

The Department of Administration capitalizes state capital construction projects for Fund 490/495. Annually, the Department of Administration will provide the Bureau of Fiscal Services (BFS)/Special Services & Financial Statements (SSFS) a listing of projects closed and the amounts to be capitalized. BFS/SSFS will provide this information to the Institutions to be included in the Institution's capital asset inventory report.

In addition to state capital construction projects, there are Organization construction projects (Department of Health and Family Services (DHFS) funded) and other situations that may require equipment, leasehold improvements, land, land improvements, computer software or other assets (greater than $5,000) to be capitalized in order to comply with generally-accepted accounting principles. Guidelines are presented in this bulletin for distinguishing ordinary expenditures from capital assets.

POLICY

Organizations should routinely review transactions in the year of purchase to determine if expenditures should be capitalized.

GUIDELINES FOR CAPITAL ASSET VALUATION

The following guidelines are to be used to determine whether a particular valuation should be expensed <u>or</u> added to the capital asset records during the closeout of routine repair and maintenance accounts, special repair and maintenance projects, leasehold improvements, the purchase of land, equipment, or software with an acquisition cost of $5,000 or more that may not have been purchased from a capital account.

<u>Land Valuations</u>. The cost of land acquired should include:

a. The purchase price;
b. Closing costs, such as title search costs, legal fees, and recording fees;
c. Costs incurred in getting the land in condition for its intended use, such as grading, filling, draining, clearing, and surveying;
d. Demolition costs;
e. Assumption of any liens or mortgages or encumbrances;
f. Judgments levied through damage suits; and

g. Any additional land improvements that have an indefinite life.

Land Improvements. The cost of land improvements should include:

a. Culverts, fencing, flag poles, parking lots, roadways, sewer, water and electric lines, yard lighting, paving (roadways, walks, parking), shrubs, lawns, and trees.
b. Any additional land improvements that have a finite life.

Buildings and Infrastructure. The cost of buildings and infrastructure should include all expenditures related directly to their acquisition and construction. These costs include:

a. Materials, labor (including design and supervision), overhead, and costs incurred during construction;
b. Legal and architectural fees;
c. Building permits;
d. Insurance premiums during the construction phase;
e. Materials and services furnished by other State Agencies; and
f. Interest costs incurred during the construction of proprietary fund buildings and infrastructure.

Machinery and Equipment. The term equipment in DHFS accounting includes delivery equipment, office equipment, machinery, furniture and fixtures, and furnishings that exceed $5,000/unit. Costs that should be capitalized include:

a. Purchase price;
b. Freight and handling charges;
c. Insurance while in transit; and
d. Assembling and installation costs.

Capitalization of Costs Subsequent to Asset Acquisition. In general, if an expenditure improves the efficiency, or materially extends the useful life of an asset, it should be capitalized. There are four categories of expenditures that may be incurred for an asset subsequent to its acquisition. These expenditures are additions, improvements and replacements, re-installations and rearrangements, and repairs.

1. **Additions--Extensions, enlargement, or expansions made to an existing asset.** Additions should present no major accounting problems. By definition, any addition to a capital asset is capitalized because a new asset has been created. If the addition is an item that could stand alone, i.e., a new building wing, it is a separate asset, and a separate asset and depreciation records should be maintained.

   Examples of additions are as follows (coding of these transactions should be based on the work done):

   - An elevator or dumbwaiter
   - Fire alarm system
   - Security windows
   - Surveillance equipment
   - Sprinkler system, Internal
   - Acoustical treatment

2. **Improvements and Replacements.** The distinguishing feature between an improvement and a replacement is that an improvement is the substitution of a better asset-having superior performance capabilities (e.g., a concrete floor for a wooden floor) for the one currently used, whereas a

replacement is the substitution of a similar asset (a wooden floor for a wooden floor).

In both of these instances organizations should determine whether the expenditure increases the future service potential of the capital assets, or merely maintains the existing level of service. When the determination is made that the future level has been increased, the new cost is capitalized.

If the cost is to be capitalized, the carrying amount of the old assets and associated accumulated depreciation, if applicable, should be removed, if the amount is known. If the original cost and accumulated depreciation are not known, capitalize the additional cost.

3. **Reinstallations and Rearrangements.** Expenditures made to provide greater efficiency or reduce costs. If benefits from the reinstallation or rearrangement extend into future accounting periods, the expenditure should be capitalized. If the expenditure has no measurable future benefit, it should be treated as a current period expenditure.

   These are costs that will benefit future periods but do not represent additions, replacements or improvements. If the original installation cost can be estimated, along with the accumulated depreciation to date, the cost may be handled as a replacement and the procedures in paragraph 2 above should be followed. Where the original cost is not known, the reinstallation or rearrangement cost should be capitalized.

4. **Repairs** (Ordinary and Major). Repairs maintain the capital asset in its original condition.

   Ordinary repairs are expenditures that keep the asset in a state of good repair. Preventive maintenance, normal periodic repairs, replacement of parts, structural components, and other activities needed to maintain the asset so that it continues to provide normal service should not be capitalized but rather charged to an expense account. Ordinary repairs should not be capitalized.

   Major repairs are relatively large expenditures that benefit more than one operating cycle or period. If a major repair, e.g., an overhaul, occurs that benefits several periods and/or extends the useful life of the asset then the cost of the repair should be handled as an addition, improvement, or replacement depending upon the type of repair made. Examples of repair activities are as follows:

   - Roof and/or flashing repairs
   - Window repairs and glass replacement
   - Tuckpointing
   - Painting
   - Masonry repairs
   - Floor repairs.

PROCEDURES

1. Review organization projects, leaseholds, and other accounts for items that require capitalization.

2. Update capital inventory reports, as required by Section 8—Capital Assets 1.0 (Capital Asset and Inventory Systems).

REFERENCES

DHFS APP Section 8—Capital Assets 1.0 (Capital Asset and Inventory Systems)
DHFS APP Section 8—Capital Assets 2.1 (Capitalization of Fund 490/495 Construction Projects)

CONTACTS

David Corbett
Special Services and Financial Statements
(608) 267-3903

Sally Acuff, Chief
Special Services and Financial Statements
(608) 266-9576